TRADING IN THE SEPTEMBER 1961 RYE FUTURE ON THE CHICAGO BOARD OF TRADE

September 20, 1961

UNITED STATES DEPARTMENT OF AGRICULTURE
Commodity Exchange Authority
Washington 25, D. C.

Foreword

This report summarizes the results of a trade practice investigation by the Commodity Exchange Authority covering the last day of trading in the September 1961 rye future on the Chicago Board of Trade.

The CEA from time to time makes such trade practice investigations in regulated commodity markets to determine compliance by brokers and traders with applicable regulations under the Commodity Exchange Act. An important purpose of the act is to maintain competition in commodity trading and pricing; and such investigations are designed particularly to determine whether the trade practices of floor brokers and clearing members may interfere with competition in the execution of customers' orders.

The investigation of the last day of trading in the 1961 September rye future covered all round-lot trading -- transactions in units of 5,000 bushels.[1] Trading records were examined to determine the identities of traders, the executing brokers, the exchange clearing members handling orders and trades, the types of orders, the timing of orders and executions, the prices at which the trades were made, and the amounts purchased and sold. It was thus possible to reconstruct the last day of trading in the September 1961 rye future, to show how traders' buy and sell orders were handled, and how the resultant trades were executed.

The publication of reports on such investigations is designed to provide the public and the trade with information on trade practices in commodity markets operating under the Commodity Exchange Act.

---

1 Trading in "job lots" -- transactions in units of 1,000 bushels -- were not included.

Summary

The last day for trading in the September 1961 rye future on the Chicago Board of Trade was September 20, 1961. Excessive concentration on that day in the handling by brokers of customers' orders for the purchase or sale of the September future severely restricted competition.

Most of the customers' orders in the September 1961 rye future that day were directed by the various clearing members of the exchange to the partners of a single brokerage firm. One of these partners designated a single floor broker to handle all customers' market and limit orders.

It was common knowledge in the rye pit that this broker had been selected to execute customer business, as indicated by the fact that even brokers not dealing through the above-mentioned brokerage firm gave their customer orders to him for execution. Of the 21 brokerage firms handling customers' orders during the day, all such orders of 11 firms went to the designated floor broker, and orders of most other brokerage firms also went to this broker for execution. As a result, this floor broker handled about three-fourths of all customer business -- excluding spreads -- executing 700,000 bushels of customer purchases, and 230,000 bushels of customer sales.

This broker thus held nearly all customers' orders, and necessarily executed most of them by selling to or buying from "locals", members of the exchange who are on the trading floor. Thus, there was very little

opportunity for customers' orders to "meet in the pit". In fact, less than 5 percent met in the pit, more than 95 percent being traded with locals on the opposite side.

With this concentration of customer orders in the hands of a single broker, in numerous cases customers giving market orders to buy paid higher prices than the price immediately preceding, and customers giving market orders to sell received less than the price immediately preceding. Since the orders of many customers, whether buyers or sellers, were executed at prices unfavorable to them, obviously the locals on the other side of the trades obtained favorable executions pricewise.

The investigation of the last day's trading in September 1961 rye, showing that competition in the execution of the customers' orders was severely restricted, tended to confirm an earlier CEA rye investigation which showed only 15 percent of customers' orders meeting in the pit.

Results of the investigation of trade practices in the September 1961 rye future were brought to the attention of officials of the Chicago Board of Trade and representatives of those clearing firms who had September rye trades executed for customers on that day. After study and recommendations by the Floor Practices Committee measures were taken by the exchange designed to improve competitive conditions.

Trade practice investigations in this and other regulated commodity markets will continue to be made from time to time by the Commodity Exchange Authority.

INVESTIGATION OF TRADE PRACTICES IN THE SEPTEMBER 1961 RYE FUTURE ON THE CHICAGO BOARD OF TRADE

September 20, 1961

Unusual trading activity and price fluctuations occurred on the last day of trading in the September 1961 rye future on the Chicago Board of Trade.

The size of the rye futures market during the summer of 1961 had been larger than usual, and trading was very active, with substantial public participation.

In the September future numerous small traders and a few large ones[1] delayed closing out their positions until the last day of trading, which was September 20.

In this situation total contracts remaining open in the September future at the beginning of the trading session on September 20, amounting to 961,000 bushels, were relatively large for a final trading day in the rye market.

---

1 A large trader in rye futures under CEA reporting requirements is one holding 200,000 bushels or more in one future; a small trader is one with positions below that level.

The trading in September rye on the final day, amounting to 1,253,000 bushels, was the largest day's volume during the delivery month. In this trading the open contracts were reduced by 752,000 bushels. The small traders liquidated all their long positions, and covered all but a negligible portion of their short positions.

Of total trading in September rye during the day, purchases of 910,000 bushels and sales of 285,000 bushels resulted from the execution of customers'[1] market and limit orders. The indicated amount of customer purchases was thus much larger than the amount of customer sales, due to the fact that the predominant market interest of such customers during the day was to make covering purchases to close out their short positions before trading in the future ceased.

The distribution by brokerage firms of the 910,000 bushels of purchases and 285,000 bushels of sales for traders other than executing brokers is shown in table 1. The 21 brokerage firms handling the market and limit orders resulting in these purchases and sales are designated in the table 1 as firms A through U.

---

1 "Customer" as used here means a trader other than the executing broker.

Most Customers' Orders Executed by a Single Broker

As shown in table 1, all the customer trades for the first 11 brokerage firms, A through K, amounting to about 33 percent of the total, were executed by a single floor broker, FB^1. The same floor broker also executed the bulk of the customer trades for 7 other firms, L through R, whose customer trades by this floor broker accounted for about 44 percent of the total. The only firms not having any trades executed by this floor broker were S, T, and U, whose transactions in the September future were almost negligible.

The customer business of firms A through K flowed through a single firm to broker FB^1 who had been designated by a partner of that firm to handle all customer market or limit orders in the September 1961 rye future on the last day of trading. The bulk of the customer business of firms L, M, N, and O also flowed through this firm to broker FB^1.

Floor broker FB^1, executing customers' orders for most of the brokerage firms having such orders, bought 700,000 bushels and sold 230,000 bushels on such orders, thereby accounting for 77 percent of total customer purchases and 81 percent of total customer sales in the September 1961 rye future on the last day of trading in the future.

Table 1.--September 1961 rye future: Purchases and sales[1] for traders other than executing brokers, listed by brokerage firms, Chicago Board of Trade, September 20, 1961

Brokerage firm	Total		Executed by broker FB[1]			
	Bought	Sold	Bought	Sold	Bought	Sold
	(1,000 bu.)		(1,000 bu.)		(Percent of total)	
A	85	45	85	45	100	100
B	25		25		100	-
C		15		15	-	100
D		5		5	-	100
E		10		10	-	100
F		10		10	-	100
G	25		25		100	-
H	20		20		100	-
I	20	5	20	5	100	100
J	25		25		100	-
K	85	10	85	10	100	100
L	5	5		5	0	100
M	135	10	20	10	15	100
N	265	60	255	60	96	100
O	40	25	40	5	100	20
P		10		10	-	100
Q	100	45	95	25	95	56
R	10	15	5	15	50	100
S	65		-		0	-
T	5		-		0	-
U		15		-	-	0
Total	910	285	700	230	77	81

1 Excludes transactions which were executed in partial fulfillment of spread orders, and job-lot transactions.

That this floor broker had been designated to execute customers' orders was common knowledge in the rye pit, and was respected by other floor brokers. This is indicated by the way in which orders of firms P, Q, and R were executed. For, although orders handled by these firms did not go to the partners of the dominant firm but to other brokers, the latter nevertheless directed most of their orders to the designated floor broker for execution.

The customer business shown in table 1 distributed by brokerage firms is presented again in table 2 according to distribution by executing floor brokers. The 7 floor brokers executing the indicated amount of customer business are designated FB^1, FB^2, FB^3, etc.

Table 2 shows, as already indicated, that the designated floor broker, FB^1, purchased 77.0 percent and sold 80.7 percent of the total volume transacted for customers on market and limit orders. Even a part of the small amount of customer business handled by FB^2 should have gone to the designated floor broker, according to a statement which he (FB^1) made to the Commodity Exchange Authority. The remaining executions, by floor brokers FB^3 through FB^7, resulted from oral orders which, for various reasons, were given directly to these floor brokers.

In brief, nearly all customers' market and limit orders, except oral orders specifying the executing broker, were executed by the single floor broker, FB^1, who had been designated to execute customers' orders in the September rye future.

Table 2.--September 1961 rye future: Purchases and sales[1] for traders other than executing brokers, listed by floor brokers, Chicago Board of Trade, September 20, 1961

Floor broker	Total		Percent	
	Bought	Sold	Bought	Sold
	(1,000 bushels)			
FB1	700	230	77.0	80.7
FB2	85	20	9.3	7.0
FB3		20		7.0
FB4	5		.5	
FB5		15		5.3
FB6	5		.5	
FB7	115		12.7	
Total	910	285	100.0	100.0

1 Excludes transactions which were executed in partial fulfillment of spread orders, and job-lot transactions.

Most Customers' Orders Executed by Trading with Locals

One test of free competition in a futures market with active customer participation is the frequency of customers' orders "meeting in the pit." Customers' orders meet in the pit when a floor broker with a customer's order to buy trades with a broker with a customer's order to sell. In a futures market with substantial customer business, the proportion of customers' orders meeting in the pit will be considerable. Ordinarily, in a freely competitive market, the larger the proportion of customer business, the larger will be the proportion of customers' orders meeting in the pit.

As already shown, the customer business in the September 1961 rye future on the last day of trading was very substantial, accounting for approximately half the total trading in the future that day. In trading with such substantial customer participation, it would be expected that a very considerable proportion of customers' orders would be executed against customers' orders on the opposite side.

This could not happen, however, in the market here considered, since one floor broker had been designated to execute customers' orders, and most brokerage firms and floor brokers respected this arrangement. Since nearly all customer orders, whether to buy or sell, were directed to the designated broker, he could only execute them by trading with exchange locals.[1]

---

1 Under rules of the Chicago Board of Trade, a floor broker may not execute his customer's buy order against the sell order of another of his customers or take the other side of a customer's order into his own account.

Thus, the opportunities for customers' orders to meet in the pit were very few. This restriction on competition, as shown below by analysis of the number of transactions, is even more pronounced than the analysis of the number of bushels traded as reflected in tables 1 and 2.

The total number of trades in the September 1961 rye future on the last day of trading was 111 -- that number of purchases and a like number of sales. The distribution of these trades, by type, was as follows:

Trades by locals with locals	7
Trades for customers with customers' orders meeting in the pit	5
Trades for customers with locals on the opposite side	99
Total	111

Of the 104 trades involving customers' orders, floor broker FB[1] handled the customer executions in 87 trades, acting as buyer in 49 trades and seller in 38. Of the 87 transactions entered into by him for customers, there were only 5 in which a customer's order to buy met a customer's order to sell. In the other 82 transactions he traded with Chicago Board of Trade locals. Thus, as a result of most customers' orders being directed to a single executing broker, less than 5 percent of the trades involving customers' orders consisted of such orders meeting in the pit.

Prices Registered in the Execution of Customers' Orders

The restriction on competition resulting from the concentration of customers' orders in the hands of a single broker worked to the disadvantage of numerous customers.

This is reflected by analysis of price changes registered by trades involving customers' market orders on one side and locals' trades on the other. During the day there were 64 such trades, of which 37 registered price changes. Of the 37 trades which were made at prices higher or lower than the previous trade, 24 involved customers' orders to buy and 13 customers' orders to sell. In all instances when a customer was the buyer in these trades he paid a higher price than the last price previously registered, and in all but three instances when a customer was the seller he received a lower price than the last price previously registered.

Most of the price changes registered during the last day of trading in September 1961 rye involved the execution of customers' market orders at prices unfavorable to them, and favorable to the locals on the opposite side.

Of the day's 36 price advances, 24 were registered when customers' orders to buy at the market were being executed, and only 3 on the execution of customers' market orders to sell. Of the day's 18 price declines, 10 were registered in the execution of customers' market orders to sell, and not a single one in the execution of a customer's market order to buy.

Measures for Maintaining Competitive Executions

The results of the investigation of trade practices in the September 1961 rye future on September 20, 1961, were brought to the attention of the Directors of the Chicago Board of Trade and representatives of those clearing firms who had September rye trades executed for customers on that day in meetings with CEA officials in March 1962.

As a result of these meetings, the Board of Directors instructed the Floor Practices Committee of the exchange to study the CEA findings and make recommendations to the Board for remedial action.

On the basis of recommendations by the Floor Practices Committee, the Board of Directors ordered exchange clearing firms to take action to avoid undue concentration in the handling of customers' orders. Clearing firms were directed to distribute their orders among a sufficient number of brokers to maintain competitive executions, and to designate in writing to the Secretary of the Board of Trade, the person responsible for their operations on the exchange floor. On June 20, 1962, the Secretary of the Chicago Board of Trade sent a notice to exchange members advising them of the order of the Board of Directors.

The Commodity Exchange Authority will continue to make investigations of trade practices on this and other exchanges from time to time in an effort to assure free and open competition in the execution of trades.